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THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

September 5, 1986

MEMORANDUM

TO: THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: Possible Measures for Inclusion in a Trade Assistance Package for the Philippines

Issue

President Corazon Aquino will be on a state visit to Washington on September 17-18. It is expected that she will want to discuss U.S. economic assistance to the Philippines, including possible trade measures.

After the change of government in the Philippines, the Administration expressed a determination to assist the new leadership in reviving economic growth in the Philippines. The Chairman of the EPC requested an analysis of trade options for achieving this goal.

Recommendations

The TPRG and a special Working Group reviewed a number of options for providing trade assistance to the Philippines. They found that an effective trade assistance plan should include: (1) an opening of the U.S. and Japanese markets to increase traditional Philippine exports, especially in products with high domestic value-added, which would have an immediate impact on employment and rural incomes; and (2) measures to stimulate exports in non-traditional products, especially manufactured goods and other products with high domestic value-added.

The TPRG unanimously recommends that the Administration undertake four measures, none of which require legislation, to assist the Philippines:

1) Negotiate a more liberal textile agreement with the Philippines to replace the existing agreement which expires at the end of 1986.

2) Propose establishment of a Japan-U.S.-Philippines Trade Committee for one year to develop a coordinated package of trade liberalization measures in all three countries that would

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be of assistance to the Philippines.

3) Provide the Philippines with more liberal treatment under GSP by granting Philippine competitive need waiver requests in the GSP General Review even if we are not fully satisfied with their responses to our requests for country practice improvements.

4) Expand U.S.-Philippine trade and investment by establishing a Business Promotion Council with high-level government and business participation.

The TPRG unanimously opposes the following option:

5) Propose legislation which would provide duty-free treatment for Philippine exports for five years (with a one year phase-out period).

After extensive debate on the question of sugar, the TPRG developed two suboptions for Council consideration. The TPRG unanimously opposes suboption B and most agencies support suboption A:

6) Improve treatment of the Philippines under the Sugar Program.

Suboption A: Maintain our current policy of non-discriminatory application of the existing quota, but express our willingness to consider possible forms of commodity donations to compensate countries affected by the sugar quota, in the event that their import quota is reduced in the coming years.

Suboption B: Discriminate in favor of the Philippines by eliminating quota eligibility for net-sugar-importing countries and reallocating the amount to the Philippines.

Background

-- The Philippine economy and per capita income have been contracting since 1983. The GNP fell 6.8 percent in 1984 and 3.8 percent in 1985. Current estimates are that the Philippines will not grow measurably in 1986.

-- The country continues to face its most difficult postwar economic crisis, including a depressed investment environment, 26 percent underemployment, extremely low prices for its major commodities (i.e. coconut oil, copper and sugar), and extensive poverty.

-- The Philippines remains a heavy debtor, with an overall external debt of $26 billion and a debt-service ratio of 36.5 percent after rescheduling of principal repayments.

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-- The United States is the Philippines' largest trading partner. U.S. imports from the Philippines in 1985 were $2.1 billion, while our exports totaled $1.4 billion, resulting in a $760 million surplus in favor of the Philippines. Trade turnover between the United States and the Philippines fell 14 percent between 1984 and 1985 and dropped a further 12 percent in the first six months of 1986 compared to the same period in 1985, with exports of both countries declining.

-- The largest U.S. import from the Philippines is electrical machinery (assembled U.S. parts), followed by apparel and vegetable oil. Our largest export is electrical machinery for assembly, followed by cereals.

Discussion of Options

1) Negotiate a more liberal textile agreement with the Philippines

The present bilateral textile agreement expires at the end of 1986. The Philippines have requested early renegotiation and a number of liberalizing changes as their best prospect for expanded exports and increased employment in depressed areas. Among ideas floated by the Philippine government are large quota increases, including merger of the adult and children apparel quotas, increased growth rates, and CBI-type treatment under which they would assemble American made and cut fabrics to obtain additional quota.

The Philippines is the 12th ranking textile and apparel supplier to the United States, with a 2.37 percent share of overall U.S. imports. U.S. imports of textiles and apparel from the Philippines in 1985 were valued at $487 million, comprising nearly 25 percent of total Philippine exports to the United States. Embassy Manila reports that each additional $1 million in apparel exports provides 400 additional jobs, many of which are in the provinces. Thus, a 10 percent increase in garment exports would provide nearly 20,000 additional jobs.

Negotiations on a revised bilateral textile agreement are scheduled for the week of September 8th. U.S. textile negotiators believe that they can liberalize significantly the Philippine agreement. They prefer not to decide in advance of the negotiations exactly which elements of the agreement they should liberalize, as this will depend in part on how much weight Philippine negotiators place on various liberalization options.

Advantages:

-- As Philippines has a developed textile industry and a proven export potential to the U.S., increased quotas would have an immediate beneficial effect on export earnings and employment.

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-- Liberalization of the textile agreement can be accomplished administratively, without GATT/MFA problems.

-- Preferential treatment for poorer developing countries is consistent with our textile policy.

Disadvantages:

-- The textile and apparel lobby and its congressional supporters would oppose negotiation of a more liberal agreement. Granting the Philippines more favorable treatment could be particularly sensitive given the legislative climate after the Jenkins Bill veto override effort.

-- The current trade deficit makes this an inopportune time to liberalize any bilateral textile agreement.

2) Establish a Japan-U.S.-Philippines Trade Committee for a period of one year to develop a package of trade liberalizing measures in each country that would be of benefit to the Philippines

The principal purpose of this option is to bring Japan to the table to discuss market-opening measures that it could take to stimulate Philippine exports to Japan, as the United States should not be the only country taking such steps. If there were a trilateral discussion, Philippine requests would not be directed only at the U.S. It would be advisable to keep these discussions distinct from our own bilateral market access discussions with Japan so that any Japanese liberalization steps are not counted as a response to U.S. requests.

Another purpose of the Committee would be to provide a forum for discouraging the Aquino government from adopting an inward-looking economic recovery plan. There are some indications that certain elements in the new government favor excessive protection of domestic industries. We might be able to curb such tendencies by early discussions with policy-makers. We also would have an opportunity to encourage the Philippines to improve its climate for foreign investment. Some early assurances by the GOP in the investment area would be desirable, particularly regarding stability of investment rules, transparency of investment regulations, and timely review of investment applications. Raising such issues in a trilateral context would make the United States appear less intrusive than if we were to raise them bilaterally.

Japan has major political and security reasons for helping to revitalize the Philippine economy. It is the Philippines' second largest trading partner, with $1 billion in 1984 imports from the Philippines and exports of $815 million. In the current "GATT-12" talks, we are asking Japan to eliminate the quota on imported

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pineapples and pineapple juice, which would also benefit the Philippines. Although Japan is Philippines' largest export market for pineapples, in 1984 it imported only 297,000 net kilograms of pineapple juice from the Philippines, compared to 17 million net kilograms imported by the United States. The Philippines ships some $200 million in coconut oil to the United States and EEC each, but, due to high duty rates, only $20 million to Japan. Japan's tariff rate on coconut oil is 9percent or 10 yen/kg, whichever is higher, compared to a zero U.S. tariff rate. Philippines would also benefit from Japan's duty reductions on fresh bananas (12.5 percent April-September and 25 percent October-March), preserved bananas (40 percent and 50 percent for the respective time periods), plywood (20 percent), tomato paste (25 percent). Japan also could eliminate various NTB's that inhibit imports from the Philippines (e.g., requirement that Philippine bananas exported to Japan be shipped only in Japanese-made boxes.)

The proposed Committee would be established for a one-year period only. This would require Japan to give a formal response to the Philippines within a reasonable period. Also, a temporary Committee would not be seen as competing with established ASEAN-wide consultative arrangements with both Japan and the United States.

If this option is adopted, the TPSC will draw up specific proposals, for TPRG evaluation, on how the Committee should operate and on how to approach Japanese officials with the proposal.

Advantages:

-- Greater market access to Japan would be of significant additional benefit to the Philippine economy.

-- Getting Japan to open its markets is beneficial to the world trading system.

-- Getting Japan to make significant concessions would make it easier to argue in Congress for U.S. concessions for the Philippines.

Disadvantages:

-- None.

3) Provide the Philippines with more liberal treatment under GSP by granting Philippine competitive need waiver requests in the GSP General Review even if we are not fully satisfied with their responses to our requests for country practice improvements

To increase Philippine utilization of the U.S. GSP program, we have agreed to a request by the Government of the Philippines

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to sponsor a series of UNCTAD GSP seminars in the Philippines from October 14 - 24. A substantial amount (approximately $75 million) of GSP-eligible imports from the Philippines is not entered duty-free under GSP for administrative reasons (inadequate documentation or failure to meet rules of origin criteria). Our experience in other countries is that GSP seminars can improve the utilization of the program and result in increased duty-free benefits. The seminar is being funded by AID and will include experts from all the major GSP donor countries.

The GSP program provides duty-free entry for a broad range of goods from developing countries. However, if a country's exports of a product exceed certain statutory "competitive need" limits, the country loses GSP eligibility for that product, unless a "competitive need waiver" is granted.

Under the GSP General Review, the Philippines requested waivers of competitive need limits on 4 products for which they had already exceeded the limits and lost duty-free treatment, with 1985 shipments to the U.S. of $136 million. We have already granted waivers under existing statutory authority for three of these requests. The remaining item is sugar, with 1985 trade of $124 million. From a domestic economic sensitivity standpoint the sugar waiver could also be granted. The waiver would allow the Philippines to maximize its export earnings even if sales continue to be limited by a sugar quota.

According to Embassy Manila, the benefit of duty-free treatment for sugar would be likely to accrue to producers, as Philippine export contracts contain a provision that any reduction in the U.S. duty will pass through to exporters. Also, all sugar exporters, large and small, would benefit, as 16 percent of everyone's sugar production is exported to fill the U.S. quota.

In addition, the Philippines requested competitive need waivers on 7 products where import levels are near, but not over, competitive need limits with 1985 shipments to the U.S. of $84 million. An interagency decision has been made that granting these waivers would not have an adverse impact on the U.S. economy. Granting of these waivers would not have an immediate impact on Philippine exports but would be of benefit in the medium and long-term as it would make investment to expand production of these items more attractive.

Before granting competitive need waivers, the President is required to consider a number of factors including the country's practices relating to trade, investment and worker rights. We have been consulting with the Philippines, and we informed them that market liberalization to date would be taken into account in making our decision on competitive need waivers, but that we would also require, at a minimum, a firm commitment for improved enforcement of their intellectual property laws, and an update on

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planned worker rights reforms.

The Philippine government has taken note of U.S. concerns, but the press of other priorities may make it difficult for the GOP to respond to U.S. concerns in time to gain credit under the GSP General Review, i.e. by September. It is recommended that we continue to consult with the Philippines and press for changes, but, if necessary, settle in the end for a commitment by the Philippines to continue exploring the issues with us. This decision could not be announced during President Aquino's visit, since the General Review will not be completed until the end of the year. Any waivers granted under the General Review would not go into effect until July 1, 1987.

In determining at this point to grant all Philippine requests for competitive need waivers, without obtaining country practice improvements, we would apply a slightly more lenient standard to the Philippines than to other GSP beneficiaries at comparable levels of development. Such a change in policy for one country could also be interpreted as contrary to the legislative intent behind our waiver authority.

Advantages:

-- Reinstituting duty-free treatment under GSP for sugar would increase Philippine export earnings without adverse effect on the U.S. economy.

-- Granting remaining waiver requests would inject some certainty for duty-free access for these products through 1993 and may attract more investment to these industries.

Disadvantages:

-- We would be giving up limited leverage for seeking improvements in Philippine practices.

4) Expand U.S.-Philippine trade and investment by establishing a Business Promotion Council with high-level government and business participation

A high-level U.S.-Philippine Business Promotion Council, consisting of government and business representatives, could be a useful vehicle for pursuing opportunities for economic expansion through increased trade and investment. The Council could coordinate and expand the wide range of ongoing efforts in this area. If this option is adopted, the TPSC will draw up specific proposals for the operation of the Council.

While the Japan-U.S.-Philippines Trade Committee (Option 2), as well as regular government contacts, would be the venue for discus-

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sion of the Philippine foreign trade and investment policies, the Council could be useful in promoting trade and investment. The Council would not be a forum for resolving trade and investment disputes with the Philippines; rather, it would provide an umbrella vehicle for trade and investment promotion.

The Council could facilitate offshore processing in labor intensive industries and developing the Philippines as a larger source for U.S. food distribution companies. It could attempt to tap the technical and capital resources of U.S. companies and try to stimulate their interest in areas in which the Philippines has a comparative advantage.

The Council could conduct specialized seminars in U.S. cities where there is a concentration of relevant industries. It could work with private sector groups interested in organizing specialized missions to the Philippines to meet joint venture partners and, in the case of U.S. marketing companies, suppliers. It also could examine what measures OPIC could take to improve future prospects for U.S. investment in the Philippines.

The Council could also explore which sectors should be targeted for development. For example, Philippine chrome ore production, according to the Bureau of Mines, could be doubled through increased investment. Development of Philippine deposits of chromium may be useful given potential uncertainties of supplies from South Africa. The TDP is already considering a feasibility study for a joint venture between the U.S. and a Philippine company on expansion of a chromite mine on Palawan Island. However, it is important to note that the GSA stockpile currently has an excess supply of chromium and is not in a position to purchase additional production. In fact, GSA may become a seller of its excess chromium. Any decision to expand Philippine production should be based solely on economic viability.

In addition, the Council could oversee a number of technical assistance activities. USDA and Commerce could organize business outreach activities, including trade and investment missions and trade shows. Other possibilities include FDA and APHIS assistance to improve the quality of Philippine foodstuffs intended for export to the United States. AID could provide assistance to train Philippine executives in marketing and sales strategies for introducing new products to the U.S. market.

Advantages:

-- Active promotional programs would be highly visible and beneficial for targeted sectors.

-- Creation of the Council would show responsiveness to recent GOP interest in having a trade and investment program established during the Aquino visit.

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Disadvantages:

-- On its own, this option would be viewed as being of limited economic benefit.

5) Propose legislation to suspend duties on a non-MFN basis for Philippine dutiable exports for a five year period (with a one year phase-out period) to stimulate the export sector and to provide increased export earnings

In 1985 approximately $1.5 billion or (70 percent) of U.S. imports from the Philippines were dutiable. The amount of duties collected was $144 million, which is an average rate of 9.6 percent. Duty suspension on these products would provide the Philippines with an important temporary margin of advantage that could stimulate additional production. Temporary duty suspensions on items that are constrained by quota, such as textiles, would maximize export earnings to the Philippines on these items in the short term but would not lead to increased investment in these sectors which are import-sensitive in the U.S. economy. It should be acknowledged, however, that many of these items are dutiable (i.e. not subject to GSP) due to varying degrees of import sensitivity. In addition to textiles and apparel, they cover agricultural products such as pineapple juice and tobacco (see below).

Duties would be removed for all dutiable imports from the Philippines for a five year period. In the sixth year, fifty percent of the duty rate would be reinstituted, and the full rate would be applicable in the seventh year. A one year phase-out of the duty preference would prevent excessive disruption from an immediate reinstitution of full duties.

Legislation would be required to suspend duties. A GATT waiver under Article XXV would also be required if the action were to be taken on a non-MFN basis. Article XXV requires approval by two thirds of the votes cast and more than one half of the contracting parties. We can expect opposition on principle, since MFN treatment is one of the pillars of the GATT, and due to some countries' fears that the Philippines' preference would disadvantage their exports. These obstacles would probably not be insurmountable, since there is widespread international support for the new Aquino government, especially within ASEAN.

Important imports from the Philippines currently subject to duty, and not otherwise eligible for GSP (with value of 1985 imports from the Philippines, the ad valorem duty rate, and Philippine supplier rank), include:

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TSUS Item	Description	Value ($ mil.)	Duty Rate (percent)	Rank
148.98	Canned pineapples	74.4	1.5	1
715.05	Watches	59.3	10.1	4
383.23	WGI apparel, mmf*	31.0	34.0	1
376.24	Body support garments*	24.7	32.0	1
705.35	Gloves	24.4	15.0	2
383.47	WGI apparel, cotton*	22.4	16.5	7
240.17	Plywood	21.3	8.0	3
704.32	Lace, net gloves*	20.8	25.0	1
379.95	MB apparel, mmf*	19.7	30.0	7
165.46	Pineapple juice (other)	15.9	7.3	1
376.28	Body support garments*	15.4	18.0	1
379.40	MB cotton knit shirts, sweaters*	14.3	21.0	7
737.24	Dolls, except stuffed	13.7	14.8	4
688.12	Ignition wiring sets	11.2	5.0	4
112.30	Canned tuna	10.5	6.0	4
383.08	Lace apparel, WGI*	10.3	26.0	2
165.44	Pineapple juice(not concentr.)	5.8	17.3	1
383.20	Lace apparel, WGI*	5.8	34.0	2
170.60	Strap tobacco	4.6	21.5	3
315.35	Abaca cordage**	3.9	6.8	1
383.03	Lace apparel, WGI*	3.3	26.0	1
222.40	Bamboo baskets	3.0	10.0	2

* subject to quota
** Philippines request in 1986 GSP Annual Review for GSP duty-free treatment.

(The alternative of granting duty-free treatment on a most favored nation basis for products in which the Philippines is among the top suppliers has also been considered. This alternative was rejected because significant benefits of such reductions would accrue to countries beyond just the Philippines, although the Philippines would be among the principal beneficiaries -- see supplier rank column above. Due to domestic import sensitivity, there would be strong opposition to MFN duty-free treatment for most of the products of importance to the Philippines, such as apparel, leather products, watches, tuna, etc.)

Advantages:

-- Duty suspension would give an immediate competitive advantage to the Philippines, increase employment and export earnings and stimulate investment.

-- This is one of the few options that would be of significant benefit across several sectors of the Philippine economy.

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